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C O N F I D E N T I A L SECTION 01 OF 02 RIYADH 001520

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SUBJECT: SAUDI MINISTRY OF PETROLEUM RETHINKING GAS USE

REF: (A) RIYADH 1397 (B) DHAHRAN 74 (C) DHAHRAN 228

Classified By: Ambassador James B. Smith, reasons 1.4 (b and d).

11. (C) Summary: The Saudi Ministry of Petroleum continues to grapple with how best to use Saudi Arabia's available natural gas resources. While international oil companies working in the Empty Quarter have found some new deposits of gas, they are very deep and will pose technical challenges to develop. The Ministry is looking for ways to make them commercially attractive to develop. Saudi Arabia is also considering ways to make exploration for oil and gas in the Red Sea more attractive. The Petroleum Ministry is also working with other ministries to make better use of existing natural gas resources, including fostering the development of industrial clusters that are more likely to generate long-term jobs. The Ministry is actively seeking more American investment in these clusters. End Summary.

Upstream Gas:

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12. (C) Prince Faisal bin Turki, Deputy Minister of Petroleum, recently told EconCounselor that the Ministry is very pleased with the performance of exploration companies in the Empty Quarter during the most recent round of exploration activities. He said that all the companies had found some natural gas, although almost all of it is tight, rich (i.e. wet) gas at great depth (e.g., 17,000 feet). This will be very expensive to produce, in part because it must first be fracked before it can be brought up such a long distance. Particularly if oil prices remain relatively low, these discoveries may not be commercially viable for the time being. He said that the Ministry is evaluating the potential to develop one or two areas as a test case, although he forecast that it will not be easy to strike a deal with the companies that will allow them sufficient return. He said it was a shame that no American companies were involved in this round, although he singled out Chevron for expressing strong interest in the last bid round.

Red Sea Exploration:

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13. (C) Prince Faisal said that the Ministry will continue to explore for oil and gas in the Red Sea and the Gulf. Companies have expressed interest in the Red Sea, although they have asked that the Ministry provide initial seismic data to allow them to meet Aramco's tough criteria (Aramco expects them to find oil more often than in standard exploration operations given the relatively easy conditions). He said the Ministry is sympathetic to the approach, and may even drill a couple of test wells to give the companies enough data to reduce the technical risk.

14. (C) The Ministry has a number of oil prospects it could develop, according to Prince Faisal. However, the Ministry will not proceed unless it is confident it can develop the projects economically over a 20 year horizon. He said that Saudi Arabia has been burned enough times before, such as in

the 1980's, with too rapid expansion that was not brought on line to pursue expansion plans without careful thought.

Domestic Gas Use:

15. (C) He said that Saudi Arabia will never have enough gas, particularly at the prices the Kingdom charges domestic users. He argued that the country must increase prices, but recognized it would have to be a slow, deliberative process. The government would be much more careful about approving projects that seek to use gas in the future, seeking to avoid the decisions of the 1970's and 1980's, when the Ministry "gave gas away." While this helped a lot of companies start production of petrochemicals quickly, in the end, the only real effect was to make these companies a lot of money without meeting Saudi Arabia's long-term development goals. He lamented that not enough jobs were created, and not in the right kind of sustainable sectors that would have created secondary and tertiary development incentives for private companies. For this reason, Saudi Arabia is now pursuing its cluster development strategy, seeking to invest its oil and gas resources in targeted industries that have positive spillover effects. In that regard, he was very pleased that American companies like Exxon and Alcoa are considering investments in the Kingdom that will generate thousands of Saudi jobs.

16. (C) Prince Faisal said he was intrigued by the proposed Dow investment in Ras Tanura, but was concerned that the engineers had gotten carried away, and that the increased scale would reduce the project's ultimate commercial return.

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Looking for Greater U.S. Investment:

17. (C) The Deputy Minister made a strong pitch for greater U.S. investment across the Saudi energy sector, including in electricity production. He noted that the Ministry is working closely with the electricity regulator to come up with price guarantee contracts that will make these plants commercially attractive and reduce their potential risk. He also noted that SEC's contractual commitments are backed by the SAG's sovereign guarantee.

Comment:

18. (C) The Deputy Minister's comments that the SAG will take a much harder look at proposed uses of its natural gas resources suggests that the Petroleum Ministry remains determined to resist pressure from companies, both domestic and foreign, to develop projects that do not maximize the potential for the Kingdom's long-term development. His comments also suggest that the Empty Quarter exploration projects will not provide an easy way out of the dilemma. In the long-run, this may help the Kingdom develop a more sustainable strategy on how best to use its natural gas.

SMITH